Property Tax Reappraisal Committee

January 13, 2004
Room 317C, Capitol

MINUTES

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed. Committee tapes are on file at the Department of Revenue. Exhibits for this meeting are available upon request.

COMMITTEE MEMBERS PRESENT

Rep. Ronald R. Devlin, Chair
Sen. Emily Stonington, Vice Chair
Sen. Robert R. Story
Rep. Sen. Gary Branae
Rep. Rod Bitney
Rep. Larry Cyr

COMMITTEE MEMBERS EXCUSED

Sen. Greg Barkus
Sen. Ken Toole

STAFF PRESENT

Randy Piearson, Department of Revenue
Dolores Cooney, Department of Revenue
Rocky Haralson, Department of Revenue
Dorothy Thompson, Department of Revenue
Marion Mood, Secretary

AGENDA & VISITORS

Agenda (ATTACHMENT #1)
Visitor's List (ATTACHMENT #2)

COMMITTEE ACTION

CALL TO ORDER AND ROLL CALL

Chairman Ron Devlin called the meeting to order at 9:00 a.m., and the secretary noted the roll. **Dolores Cooney** introduced **Randy Piearson, Specialist, Department of Revenue,** who had agreed to give a presentation with regards to some of **Sen. Story's** questions dealing with the distinction between non-qualified agricultural land (Class 3) versus forestland (Class 10), including some of the changes in the Administrative Rule and the triggers causing agricultural land crossing over to residential tract land.

Mr. Piearson's handouts, ***Exhibits 1 and 2,*** provide examples of the assessed value per acre, taxable percentage rate, per-acre taxable value, and average tax for Class 3 agricultural and non-qualified agricultural land, and Class 10 forestland. He noted that non-qualified agricultural land was in the same Class 3 classification as agricultural land. The primary difference being non-qualified agricultural land had a tax rate of seven times the percentage rate of agricultural land, and non-qualified agricultural land used the same assessed value as grazing land. For his analysis, he had chosen the productivity level with the most acreage in each of these classifications. **Sen. Bob Story** wondered if "continuously cropped" farmland described the land in the Flathead Valley, which was not irrigated but farmed nonetheless. **Mr. Piearson** replied it did but generally, only the most productive farmland in the state was considered, from both a soil as well as a plant standpoint. **Sen. Story** asked whether it was the water cost, which distinguished the top graded irrigated land. **Mr. Piearson** confirmed water cost was one of the tools used in the evaluation process.

The next handout, ***Exhibit 3,*** talks about the new Administrative Rule. It defines criteria used to determine whether land is residential, commercial or industrial as it pertains to subdivisions. Montana's statutes explain land may be eligible for either Class 3 or Class 10 treatment unless it is residential, commercial, or industrial without specifically defining the three categories. Over the years, a few problems arose with subdivisions where millions of dollars had been spent on infrastructure and other improvements both above and below ground; at issue was the question whether this now had become a residential improvement even though no structures had been erected yet. After several appeals, the Department recognized this was poor tax policy because of the uncertainty developers were facing. To help alleviate this, the Department brought together interested parties from a vast cross-section and, through an "informal negotiated rules process", the Administrative Rule was crafted. **Mr. Piearson** noted the collaborators came from various backgrounds, representing the timber industry and agriculture; they were realtors, developers, and legislators, and even though the group was diverse, there was very little disagreement. He attributed this to the fact everyone was pretty single-minded about improving the process; the final vote on the new rules was unanimous.

Sen. Emily Stonington was curious about the array of developments this would impact, and asked if it changed the stock farm community in the Bitterroot Valley from an agricultural to a residential designation. **Mr. Piearson** was not sure whether it had. **Sen. Stonington** then referred to a recreational area called Gallatin River Ranch near Manhattan where people keep and ride horses on 20-acre lots and asked what property class this would fall under. **Mr. Piearson** was not familiar with this subdivision but said if it had three of the nine infrastructure developments shown under Section (d), it would be considered a residential or a commercial development. He pointed out most subdivisions will have two infrastructure developments, namely roads and utilities, be they underground or above. The real key to this rule was: once a subdivision has underground sewer and water, it is more than likely to also have roads and utilities, and possibly a storm drain system, sidewalks, and other landscaping. He noted about 98% of subdivisions in this state only had three of the nine elements in place; it was only the more upscale subdivisions which had three or more such as those at Big Sky which were

all classified residential. He went on to explain that it was possible for subdivisions to have two or fewer of the infrastructure improvements, and this could put them into a tax classification other than agricultural; if there were covenants precluding agricultural use, then it would not get an agriculture classification even though it could still be classified non-qualified agricultural. To illustrate how the new rule could work, he used the following example which, by his own admission, was somewhat extreme: a developer had only roads and utilities in place, owned lots of more than 160 total acres in a subdivision and precluded agricultural use through covenants; his property was valued at market because he neither met a non-qualified agricultural classification nor an agricultural one due to the covenants. **Sen. Stonington** asked what 'precluding agricultural' really meant. **Mr. Piearson** explained the covenants would have to be quite strict and preclude agricultural use such as raising pigs or chickens, or running livestock, but could permit growing some plants or crops. He went on to say many of the new subdivisions' covenants even include restrictions as to the color of the homes.

Chairman Devlin brought up the non-qualified agricultural charge of seven times grazing for a 20-acre or larger parcel versus a timbered parcel of the same size that did not have a provision of non-qualified timber similar to non-qualified agricultural land. He wondered if someone bought a 22-acre parcel of timberland and the acre underneath his house was considered residential, would the remaining 21 acres be taxed as timberland. Referring to the chart, he also asked what the qualifications were for Zone 5 (Grade 4) timberland, taxed at $0.32/acre. **Mr. Piearson** replied the qualifications remained the same regardless of zone, but different values were attached to productivity grade, and there were different evaluations due to market and cost. Commercial forestland must meet an acreage requirement of fifteen contiguous acres of commercial, not merchantable, forestland. The commercial classification is driven by the level of productivity, measured at 25 cubic feet of timber per acre per year, and if this requirement is met and there are no covenants prohibiting commercial logging, the land will be classified as forestland. He added this productivity level was easily met in Western Montana; it was conceivable that out of a parcel of 23 acres, 19 acres would be forestland and four acres non-forestland; with a house on the non-forest portion, all four acres would be assessed at market. The same would hold true for the example in **Sen. Story's** question: on a 20-acre tract of forestland, the acre on which the house sat would be classified as a building site, and the remaining land would be forestland. He noted this was very common in Western Montana. **Chairman Devlin** noted the group was more familiar with the provisions of non-qualified agricultural, and the requirement of $1,500 worth of production. He understood the provisions with regards to forestland to say that it merely had to show capability, not actual production. **Mr. Piearson** replied this was basically true; the forestland classification system was built on productivity and even land that has been clear-cut or been burnt was still classified as commercial forestland. The land is looked at for its historical use, and determination based on the assumption that trees will grow there again. He said he would make an exemption and take the land out of its forest classification if it was obvious land was not coming back as forestland or no new growth had occurred twenty years after a natural disaster. **Chairman Devlin** had another concern: if an area designated as forestland was clear-cut, and it had agricultural activity during the interim when trees were growing back, would it still be classified as

forestland. **Mr. Piearson** told him it would; a set of rules existed by which the proper classification of all land was determined. The first step was to take a look at a parcel or a portion thereof to see if it met the forestland requirements; if it did, it was classified as such. If a portion of the parcel did not meet the forestland classifications, his department would go to step (2) to see if it met the agricultural requirements; if it did, no other criteria were applied, and if it did not, step (3) determined whether it met the non-qualified agricultural criteria. If the property did not fall into the last category either, it automatically went to the only classification left, which is Class 4. He pointed out forestland was classified as such even if cattle were grazing on it. **Sen. Story** surmised the reason for a property class below non-qualified agricultural land was the added revenue from subdivided lots; there was no tax disincentive to subdividing property qualified as forestland. **Mr. Piearson** stated he would have to look at the Forestland Tax Act passed in 1991 and implemented in 1994 to see when the category "non-qualified agricultural" land came into play. He felt it might have come about after the Forestland Tax Act and recalled discussions relating to 20-acre parcels during work on legislation for the Forestland Tax Act. Twenty acres was sort of a magic number for a lot of decisions, including the agricultural arena, when considering usage and factoring in income; he recalled some pressure from people with tree farms who had properties of less than twenty acres and wanted forestland taxation. In the end, a compromise of fifteen acres was reached which created administrative difficulties for his office as in the example of the 19-acre lot where fifteen were deemed forestland, leaving the remaining four acres in Class 4 and valued at market. He stressed it was difficult to get true market value for four acres when both productivity and market values come into play on the same piece of property. This was what happened, though, on parcels smaller than twenty acres at which point the non-qualified agricultural category kicked in. **Sen. Story** noted the acreage criteria remained an ongoing problem; if someone had enough money to buy twenty acres of high value property instead of just five or ten which, as Class 4, would be assessed at market value, the twenty acres would fall into the forestland category and be taxed at $1 per acre. **Mr. Piearson** replied the difference in taxation between non-qualified agricultural land and forestland was not big enough for properties of this size to drive someone's purchasing decisions. In a Class 4 evaluation, though, the differences were significant. **Sen. Stonington** referred to the income requirements between agricultural and non-qualified agricultural land and asked how this was being monitored. **Mr. Piearson** advised there was no income requirement for non-qualified agricultural land. **Sen. Stonington** rephrased her question, asking if the owner of 60 acres wanted to change the classification from non-qualified agricultural to agricultural land which had the $1,500 income requirement, was he required to prove this only once. **Mr. Piearson** explained technically, this was correct since the law stated the application did not have to be filed annually. However, his office kept a close eye on properties deemed marginal; in those cases, they could ask the owners to reapply on an annual basis. He advised it was possible to miss the exact time when property converted from agricultural use, especially with larger acreage, but hastened to add this was not prone to happen more than once. He noted dealing with small tracts of agricultural land was one of the most time consuming and difficult tasks his office faced because of their complex and contentious nature, and because this category was one of the most desirable with regards to taxation; almost 100% of these taxpayers view their tax as "property tax relief". ***[Tape 1, Side B]*** He

commented the $1,500 income rule, implemented in 1986, was relatively easy to get into since the requirements were so low. **Sen. Stonington** asked whether this was a rule or statute, and **Mr. Piearson** affirmed it was statute.

Since there were no more questions, **Chairman Devlin** asked **Dolores Cooney** to talk about the "reverse annuity mortgage" loan program as requested by **Sen. Ken Toole.** She explained it was a loan against the house but might differ somewhat from what he had envisioned. She informed the members since its inception in 1991, only 74 applications had been approved, adding the department would see if surrounding states had additional information on similar programs. **Ms. Cooney** explained it was a standard loan program established by the Board of Housing which converts the equity in the home into an additional monthly income source for its owner. The owner must meet certain requirements as outlined in ***Exhibits 4*** *and* ***5.*** In answer to **Sen. Stonington's** question, **Ms. Cooney** explained the money could be used for any purpose, including the payment of taxes and stressed the applicant had to be at least 68 years old, and annual income cannot exceed $17,720 for a single person or $23,880 for a two-person household.

Chairman Devlin turned the meeting over to **Ms. Cooney** who offered another perspective with regards to the Department's ideas for change; it had to do with the issue of an annual cycle for property classes 3, 4, and 10. In Class 4 particularly, the study of other states' practices showed all of them had fairly short reappraisal cycles; states such as Michigan and Florida, which established caps of no more than a 3% increase on taxes, used annualized sales ratio studies between cycles to index properties to market value, rather than use Montana's phase-in approach. She stated the DOR would like the committee to consider annualized sales ratio studies between cycles; this may help solve the issue of annual cycles versus 6-year reappraisal since they could index properties to alleviate "sticker shock". If the committee favored capping taxes similar to the practice in Florida and Michigan, it could hold down taxes to local government. Under current law, when those properties are sold, they are taxed at the phase-in value; if the sales ratio study was employed, it would be at market value, with the cap applied after the sale. **Sen. Story** asked her to explain the term "sales ratio study". **Ms. Cooney** advised that in a sales ratio study, the current appraised value is measured against the sale: if in 2002, a house is appraised at $100,000 and sells for $110,000 in 2004, its ratio of sale price to market value is 1.10, or 10%. This means the sale price is outstripping market value by 10%. States employing sales ratio studies collect sales data for the entire year and run them through statistical analyses within neighborhoods; in the example used, they may want to index current properties by 110%, thus bringing a group of homogenous properties up to market value. Current practice would result in a potential increase of 20% between the 2003 and 2008 reappraisals; the sales ratio study might allow smaller, incremental increases throughout the cycle and thus ease sticker shock. She added it would give a more annualized picture of market value without the prohibitive costs of an annual reappraisal. **Chairman Devlin** asked how these states factored in inflation and appreciation. **Ms. Cooney** replied they were reflected within the ratio; assuming similar characteristics of homes within a given neighborhood, she stated that typically, all would age and appreciate at about the same rate. A process called AP 26 was used to address atypical homes. She advised the committee that Montana had employed the sales ratio study in the past, but it had been very short-lived and was struck down by the Supreme

Court. Arguments against it included the delineation of the neighborhoods, the consistency of and the ability to analyze the data, and the insertion of a clause prohibiting taxpayers to appeal the index. **Sen. Stonington** asked if the state had gone from the sales ratio study approach to the cyclical reappraisals. **Ms. Cooney** noted the state had always been cyclical but tried to make adjustments inside the cycle through ratio studies, and when this failed, went back to the reappraisal cycles. During the eighties, the Department had asked for an extension to finish out the cycle, which made for an unusually long period without actual reappraisals, and this was one of the things they sought to correct with the sales ratio studies. She admitted the contemplated changes were not going to be easy to implement and would require a lot of research, both from an administrative point of view as well as from the taxpayer's but saw the discussion of pertinent ideas as a good first step. **Sen. Stonington** wondered if they would not be fast-forwarding by six years were they to implement the sales ratio study today. **Ms. Cooney** agreed, saying there would be a vast gap resulting in sticker shock; if it was implemented in 2009, though, it would be graduated. The 2009 assessment would be based on a 2007 base year because of the clause in SB 461, which says, "the Department needs to be finished with the reappraisal by December 31, 2007"; this will allow for analysis in 2008, prior to the 2009 Legislature. If it was implemented in 2009, theoretically, a sales ratio index could be done for that year, and the 2007 value could be brought up to a 2009 market value. She explained the reason why states still retained a reappraisal was the period of time they needed to cover all of the properties and to ensure the characteristics were correct; this also gave them the tools to establish a base year. **Sen. Story** surmised that another "fix" would be needed in 2009 to eliminate sticker shock, and then the sales ratio study could be implemented. One advantage of the sales ratio study was that it would eliminate the need to "keep tinkering" with the system and would allow for a natural growth in Class 4 taxable value. **Sen. Stonington** added what people who were faced with these huge increases wanted was predictability, not tax cuts, and she advocated a 2% or 3% growth cap to control the increases.

Chairman Devlin commented since there were not enough sales in the small towns in his district to establish their own model, market models from other areas were being used which were unreliable because they were not indicative of the local market. This resulted in quite a few problems because the "market" which **Ms. Cooney** had referred to as "neighborhoods', encompassed three or four different towns. The larger ones, such as Sidney and Miles City, had enough sales to be their own model but smaller towns like Scobey, Terry, and Jordan were all thrown together and because of the regional spread, the data were unreliable. **Ms. Cooney** agreed that market models were still being used extensively in Eastern Montana but charged extensive analyses were being done to ensure comparability between neighborhoods. Implementation of a sales ratio study required the same type of database as the market model; it was important to take trends into account as well as making sure there was comparability; otherwise, the system would encounter a similar fate as it had before. She added technology and other tools available to the Department were much more advanced now than the first time around. **Sen. Story** wondered if the Department would not be faced with potential court challenges if this was implemented as it had happened when they re-valued portions of the state one year and others the next. **Ms. Cooney** stated he was referring to an earlier court case which

was not sales ratio related; the case came about when reappraisal values were implemented over a period of time. **Sen. Stonington** recalled a sales ratio court case having originated in Great Falls. **Ms. Cooney** agreed and expanded what was being done today to arrive at the value before the appraisal was very similar to the sales ratio study, in that neighborhood percentages were utilized in determining the phase-in process. **Sen. Stonington** suggested if the committee was to go forward with the value cap approach, every property should be assigned current market value; this would be fair and afford predictability for everyone from then on, even if it initially caused sticker shock.

Rocky Haralson gave the second part of the Department's presentation, which dealt with assessment notifications. He referred to the two spreadsheets, ***Exhibits 7*** and ***8***; one shows the current assessment notice and the other the projected assessment notice under the hypothetical proposal of ratio/trending of market value. ***Exhibit 6*** is an explanation of the hypothetical changes and their effect on the reappraisal cycle. ***[Tape 2, Side A]*** **Mr. Haralson** stated the spreadsheet served to give a visual demonstration to the committee on the impact of some of the ideas discussed. He pointed out that arriving at the taxable value was a complex process, taking into account property class, the previous year's value, current year's reappraisal, taxable value and finally, the taxable value after applying the taxable percentage. As shown in ***Exhibit 8,*** the scenario described by **Ms. Cooney** would make the following changes: removing the phase-in and the exemption amounts would eliminate sticker shock; the previous year's value of $87,000 almost doubled in 2003 at $164,000 which changed back to about $91,000 due to phase-ins and exemptions. He stated it was difficult for field personnel to explain to people planning an addition to their home, how the property had to be recalculated before reappraisal. He claimed the changes proposed by **Ms. Cooney** would also simplify the calculation of newly taxable properties because it would eliminate the multiple steps and analyses, giving predictability to local jurisdictions. In closing, he stated he had pared down the steps as much as possible but the final say was up the committee.

Sen. Story opined the more they tried to simplify the process, the more complicated it seemed to get because some facts needed to remain in the equation: people needed to know the previous appraised value, the value of any improvements they might have added, and the total value of the reappraisal. It may not be important to them to know what their phased-in value or any exemptions were but they should be able to find out by how much the value had increased from the last cycle, and whether the increase was due to improvements or the reappraisal. He felt this information should be available to the property owner on a yearly basis. **Ms. Cooney** explained that under the current cycle, taxpayers would receive their assessment only in the first year of the cycle unless they made significant changes to the property, which would affect the appraisal. **Sen. Story** insisted the taxpayer should be advised as to what his taxable value after consideration of any improvements was, even if his assessment notification was not sent out for another six years. **Ms. Cooney** commented the phase-in value, called taxable market value, was what people saw on their tax bill. This amount was based on reappraisal including applied exemptions, and she realized it was difficult for the taxpayer to understand. **Sen. Stonington** asked if people could only appeal their assessment at the beginning of each cycle. **Ms. Cooney** replied appeals could be made anytime during a cycle as long as they

were made within 30 days of the assessment notification, or until the end of June; one could not wait until the tax notices were sent out in November, for instance. **Sen. Story** advised one could not appeal that same November but was free to do so the following June. **Sen. Stonington** was concerned that the tax notice did not include any information regarding the appeals process and suggested some sort of taxpayer education at the time the notices went out. **Mr. Haralson** advised while it was not included in the tax notices, this information, including time frames and reapplication, was available in a pamphlet and available at all local offices. He empathized with people who had not done any improvements to their property and wondered what happened when they saw an increase at the end of the six-year cycle. He explained this could be due to a valuation change, a mill levy increase and so on, but, as **Sen. Story** had pointed out, they could not appeal until the following June. **Sen. Story** observed with the phase-in approach, the taxable value stayed about the same for the majority of the people; it was only people above the norm who would see an increase and who, therefore, would be affected by the phase-in. **Ms. Cooney** agreed, saying it depended on how many percentage points of the average they came within. This could happen on both sides of the spectrum even though there would not be any actual decreases; the values just would not rise at the same rate as the average value. She pointed out there usually was a vast middle who would not see any change in the taxable value if mill levies stayed the same. **Sen. Story** remarked the phase-in approach was probably only needed for 20% of the people, the rest would see about a 5% change either way. **Chairman Devlin** made the comment the November tax notices, and the information included therein, were confusing to the taxpayers; and, even though the information was available at the county appraiser's office, people were more likely to call a county commissioner who then had to refer them. He also pointed out the term "tax appeal" was a misnomer; the process was actually appealing the valuation which had taken place six months prior. This had become a big issue since people could not do anything about their tax bills until the following June. It had been his personal experience that most appraisers were very helpful, explained and took care of the problem right away, or they would be resolved through the AP 26 process. The ones which did not get resolved, would end up before the Appeals Board; he estimated this was about 10% of all complaints.

Ms. Cooney referred to ***Exhibits 9 and 10***, an overview of the appeals history and accompanying graphs. **Mr. Haralson** concurred with the chairman that most of the complaints were either resolved at the local offices or through an AP 26 process. He stated he had charted the data in two segments (1978-1986 and 1987-2003) in order to demonstrate the dramatic downward change in the numbers from 1978, when the DOR started keeping records of appeals at the county and state level, through 2003. The table on the left hand side of ***Exhibit 10*** showed actual numbers, and he explained the significant increase in appeals in 1993 was due to the fact that a private property tax specialist had come in which had generated the increase in appeals. He pointed out the complaints had not gone through the local appraisal offices but were appealed directly. This had been addressed and corrected in that the taxpayer had to go through the local Board via the AP 26 process; the numbers for 2003 were estimated since not all of the data were in yet. The graphs show a steady decrease in appeals at both the county and state levels, and the small spike in the 2003 reappraisal year was due to what the

committee referred to as "sticker shock". The Department saw improved evaluation methods, new legislation by committees such as this and efforts to educate the public on the issues as mitigating factors in the decrease of appeals because all of these factors served to mitigate "sticker shock". **Chairman Devlin** wondered if these were residential appeals as well as commercial which **Mr. Haralson** confirmed, saying residential appeals were more numerous given the ratio of residential versus commercial properties in the state.

Ms. Cooney commented the emails contained in the members' packets were news releases the Department routinely received from all over the country; she had included them to demonstrate what was happening with property tax issues in other states. **Chairman Devlin** wondered if other states had laws similar to Montana's with regards to the appeals process. **Mr. Haralson** replied all states had some form of appeals process.

This concluded the segment on the Department's ideas for change, and there was no public comment on the proceedings. **Chairman Devlin** announced the next meeting would be at 9 a.m., March 4th at the **MACo** building. He asked **Ms. Cooney** for the list of items for that meeting's agenda. ***[Tape 2, Side B]***:

- Current status and historic growth in other property classes
- Impact of the business equipment tax going to zero
- Ffirst discussion of capping tax rate growth based on the Michigan and Florida information, but reserving interactive conference for May
- Study of land exemption, with consideration of location
- Comparison of reverse annuity mortgage programs in other states.

Ms. Cooney suggested it might be helpful for the committee to look at the types of limitation other states use to cap growth, and at the sources for school funding. **Sen. Stonington** added Michigan had replaced the loss of school funding with a sales tax increase. **Sen. Story** cautioned they would also have to consider what capping would do with regards to a shift in the guaranteed tax base. It might be unique to Montana that if taxes were held down in one area, the state's resources for school funding were shifted from one area to another. He suggested having **Jim Standaert** explain this at the next meeting. **Sen. Story** recalled, while working on **Sen. Bob DePratu's** bill, that the analyses done on different percentages of caps had produced a pool showing how many people this affected. He wondered if this could be done again to give a clear picture of how many people were affected by different caps before reaching market value in a 6-year cycle. **Ms. Cooney** commented data were available which showed that by capping a portion of the population over a period of time, as was being done in Florida and Michigan, people will be paying taxes in proportion to the value of their property, and it only went to market value when the property sold.

Seeing no other comments from the committee, **Chairman Devlin** referred to an omission in the Nov. 21 minutes, namely that **Jim Standaert** had pointed out in his presentation that local governments were reimbursed when mill levies increased due to

the lowering of exemption rates; he added the mere lowering of taxable value did not totally explain why mill levies increase.

Sen. Stonington moved to approve the Nov. 21, 2003 minutes; motion passed unanimously.

Chairman Devlin adjourned the meeting at 10:30 a.m.

Minutes read and approved by _____

Representative Ron Devlin, Chair Date

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Senator Emily Stonington, Vice Chair Date